

SKF India Limited

No. of Shares (Crore)	5.27
Face Value (Rs)	10.00
Mkt. Cap (Rs. Crore)	2357.82
Price (14/06/2010)	447.15
Book Value (Rs.)	143.81
P/BV	3.11
BSE Code	500472
NSE Code	SKFINDIA
Bloomberg	SKF IN
Reuters	SKFB.BO
Volume (weekly) (NSE)	171163
52 W H/L (Rs.)	496 / 210

Shareholding pattern	%
Promoters	53.58
MFs / Banks / FIs	15.70
Foreign	12.05
Govt. Holding	0.00
Non-Promoter Corp.	3.51
Total Public	15.71
Total	100.00

(As on 31st Mar, 10)

Recommendation

BUY

Analyst

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Company Brief

SKF India, 53.5% subsidiary of the Swedish bearing giant, is the market leader in the bearing industry and is the main bearing supplier to all consumer segments: automotive, electrical, industrial and aftermarket. Along with a varied range of bearing and related products it also offers extensive solutions and services in this area.

Highlights

- SKF India has strong presence in the Indian bearing industry, commanding a market share of 30%.
- Commencement of operations at its two new plants in April 2010 will help the company to cash in on the significant growth opportunities in the domestic market. This provides revenue visibility for the company going ahead.
- SKF Global wants to make SKF India a manufacturing hub for its different products. With a strong local presence, SKF and its parent company will be able to leverage their relationships with OEMs to get new businesses from all the OEMs operating outside India.
- The company is a preferred supplier of bearing systems to some of the leading manufacturers of cars and trucks. It has tied up with Hero Honda for meeting all its bearing requirements for the next four years till 31st December, 2014.
- The company has a diversified revenue base, which acts as a hedge against slowdown in any particular sector, while giving the company ample opportunities to benefit in a growing economy.
- At the current price of Rs 447, the stock trades at a P/E multiple of 14.5 x CY10E earnings and 11.5 x CY11E earnings. We recommend a "BUY" on the stock with a price target of Rs 584, assuming a P/E multiple of 15 x CY11E earnings, an upside of 31% from the current levels, over a period of 12 months.*

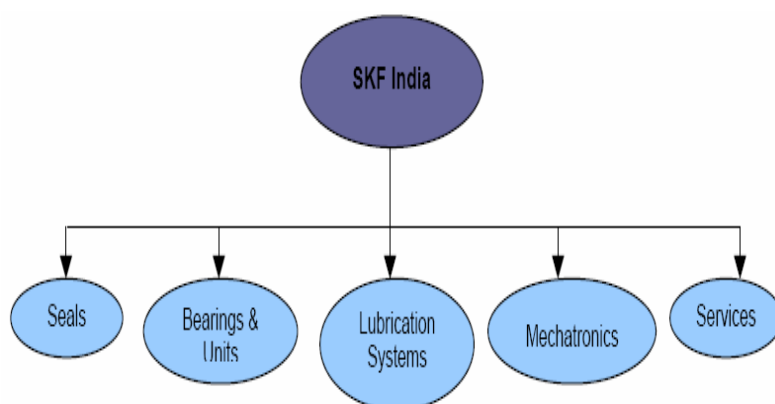
Rupees in Crores

	CY07	CY08	CY09	CY10E	CY11E
Net Sales	1567.46	1627.37	1574.97	1952.96	2382.61
Other Income	24.00	26.25	26.28	26.50	27.00
PBIDT	278.57	224.01	172.84	294.38	360.71
Net Profit	160.06	127.93	93.88	162.89	205.35
EPS	30.35	24.26	17.80	30.89	38.94
EPS Growth (%)	60.62	(20.07)	(26.62)	73.51	26.06
P/E (x)	15.61	5.75	21.65	14.47	11.48
P/BV (x)	4.43	1.10	2.75	2.69	2.18

Company Snapshot

SKF India, 53.5% subsidiary of the global AB SKF Group, is a leading technology & solutions provider of products, solutions and services in the area comprising rolling bearings, seals, mechatronics, services and lubrications systems. From a single-focus bearings-manufacturing company, SKF today concentrates on five key platforms: seals, bearings, lubrication systems, mechatronics and services. The vision driving this diversification is to exceed customer expectations in the area of bearings and related technology, and offer world-class solutions and services, turning SKF into a "preferred partner" to all its customers.

With the help of its business units, SKF India caters to the needs of specific industry segments in the country. These units are the Automotive Business Unit (ABU), the Electrical Business Unit (EBU), the Industrial Business Unit (IBU) and the Service Business Unit (SBU).



It derives 90% of its revenues from bearings comprising of ball and hub bearings, deep groove ball bearings, cylindrical roller bearings and tapered roller bearings. It manufactures more than 100 different types of bearings. The balance 10% of revenues comes from its four new technology platforms like seals, lubrication systems, mechatronics and services. The strategy has been to bundle all service platforms together so as to provide the customers an integrated solution, which can positively impact their cost of operations.

The Indian operations are among the most cost effective, with a 30-35% lower cost structure, within the SKF group. SKF also has an associate company called CR Seals India, providing sealing solutions. It is supplying wide range of products for power transmission namely timing belts, V-belts, chains, couplings, sprockets and pulleys to its customers.

Domestic business accounts for 90% of its revenues and both the automotive and industrial segment have an equal share of this pie with most of the large players being customers of SKF India. Approximately 60% of its sales of bearings are from original equipment manufacturers (OEMs) sector while the remaining 40% are after market/replacement sales.

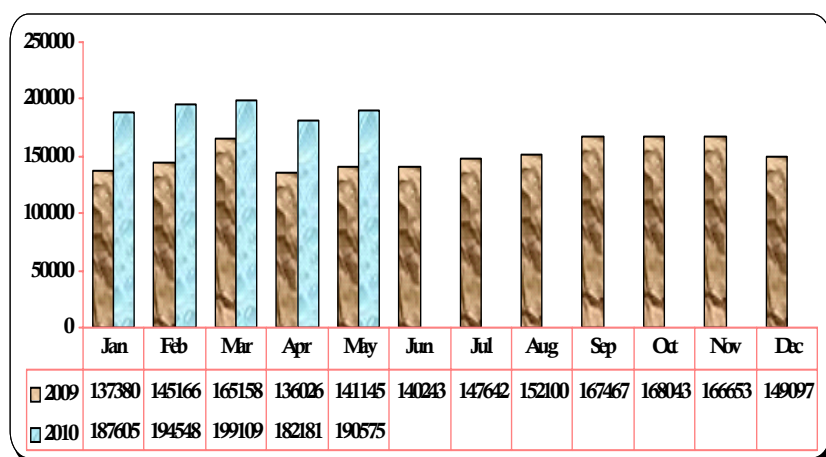
SKF India being the industry leader controls a 30% share in the Rs 57 bn bearing market in India. The company has 50% market share in the 2-wheeler OE market, 35% market share in the CV market and 35% market share in the passenger vehicle segment. In the Industrial segment, it has a 27% market share and 25% market share in the aftermarket segment.

SKF India manufactures its products out of four plants based in Bangalore, Pune, Haridwar and Ahmedabad. It has a strong distribution network with over 200 distributors across the country. The company has an application development center that helps it to develop a wide product range satisfying the needs of local market and providing a solution for any and every conceivable application.

Industry Outlook

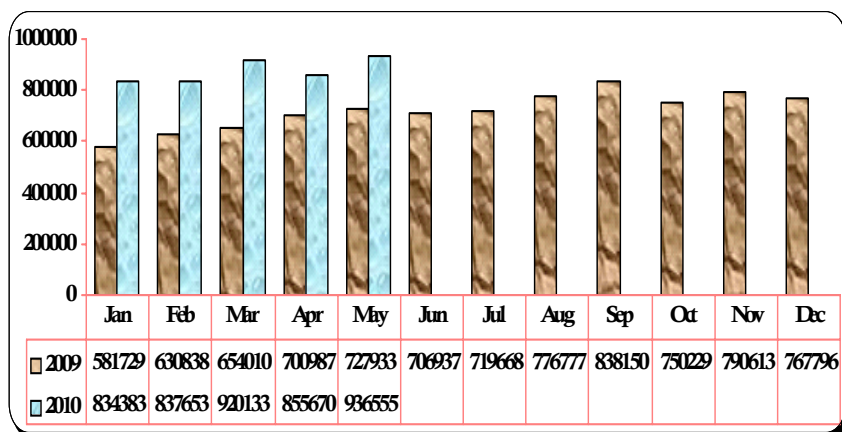
Indian Bearing market size is estimated at Rs 5700 crore. The sales of the organized bearing industry in India are estimated at Rs 2500 crore. The organised sector primarily caters to the original equipment manufacturers' (OEM) and end users, which are predominantly automotive, railways and other industrial users. The unorganized sector caters to the low end replacement market as well as forms the core of the counterfeit products in the market. **With a renewed focus on quality & reliability, this market segment is increasingly turning to the organized sector, thus benefiting organised players like SKF India.**

Automobile Sales – Passenger Cars, UVs & MUV's



The demand for bearing industry is derived from demand in two key user segments-automotive and industrial sector, where the largest user is automotive industry accounting for 50% demand. We expect all segment of automobile industry to report strong growth in the coming years. The transformation of road transport as well as higher economic growth would lead to higher demand for commercial vehicle industry. Passenger Cars continue to grow in double digit driven by rising aspirations and cheap and easy availability of finance. Within two wheelers, we expect motorcycle industry growth to continue.

Two-Wheeler - Domestic Sales



Growing educated young population in India, expansion of middle class and trickle down effects of overall prosperity in rural areas, augurs well for economic development of India. The need for effective and efficient transportation will rise more rapidly than before. At the same time, the 'value consciousness' of Indian middle class will mean that market growth will be mainly focussed in areas of motorcycles and small cars at least during the medium term.

As per KPMG report, vehicle penetration in India is quite small, even in comparison to other Asian markets. In passenger vehicle, for example, India has 8 vehicles per 1000 people, which is lower than countries like China and Thailand. In two wheelers too, the penetration level in India at 51 per 1000 is low compared to other markets such as Indonesia, Malaysia and Thailand. This gap indicates the potential for continued growth in the industry over long term.

- ✦ **The overall prospects for industrial development has remained very positive in India and hence strong demand for bearing products is expected to continue in the coming future.** As per the 11th Five-year plan of the Planning Commission, a total investment of US \$500bn is estimated to be made over 2007-2012. Considering such an aggressive plan of investments towards infrastructure, we expect the manufacturing sector to show a good recovery. The Indian government is committed to construct 20 kms of new roads everyday. A large number of public and private investment programmes in the power sector manifest Indian government's priority to this sector. Focus on renewable energy is also showing good potential over a medium to long term horizon.
- ✦ **Year 2010 poses opportunities in increasing business in growing Industrial, Rail and Automotive Markets.** Major industries consuming roller bearings viz., heavy truck, steel, cement, off-highway equipments, power transmission and farm tractors are all seeing ramping up production and firming up of demand. The automobile industry has seen a massive turnaround in fortunes, which will enable SKF India to report decent growth in its performance going forward.

Investment Arguments

Capacity expansion to propel growth

SKF India has been increasing its capacities to meet the ever increasing demand for bearings. The company has recently commenced operations at its two new plants in Haridwar and Ahmedabad in April 2010 to manufacture bearings.

The Haridwar facility is being exclusively used for automobile industry and is poised to become a hub for automotive industries in future. Being located at a tax free zone, SKF would enjoy various tax holidays. Primarily it will serve the two wheeler manufacturers in Uttarakhand, and further contribute to the growing vehicle aftermarket in India. Presently it is mainly catering to Hero Honda's plant in Haridwar after which the company will look to supply to other manufacturers also. The company has tied up with Hero Honda for meeting all its bearing requirements for the next 5 years.

The Ahmedabad factory manufactures medium to large size bearings of various types to serve customer segments such as railways, wind energy and heavy industries. It is strategically located in one of the most industrialized and fastest growing areas of India. The investment is in response to the strong global demand for large size bearings in the sectors of wind energy, mining, steel and off-road applications. Previously the company used to largely trade in the industrial bearing segment, but subsequent to the coming up of the plant at Ahmedabad, lot of manufacturing activities will be undertaken in this plant.

The company has incurred a capex of about Rs 450 crore on both plant put together. **With operations having just started, the firm is poised to cash in on the growth in the domestic market. Initially both these plants will take about a year to ramp up the production and at peak level both plants put together has capacity to produce additional sales of about Rs 600-800 crore.**

Strong Presence

SKF India has strong presence in the Indian bearing industry, commanding highest share of 30% in total 57 bn industry. It serves to almost each and every segment of the industry. The company has 50% market share in the 2-wheeler OE market, 35% market share in the CV market and 35% market share in the passenger vehicle segment. In the Industrial segment, it has a 27% market share and 25% market share in the aftermarket segment.

The company is a preferred supplier of bearing systems to some of the leading manufacturers of cars and trucks like Maruti trucks, Maruti, M&M, Tata Motors, GM, Ford and Daimler Chrysler. **SKF's strong presence coupled with growth in automobile industry is likely to keep SKF in good health.**

Diversified revenue mix

SKF India is the market leader in the domestic bearing industry with a market share of around 30%. Approximately 60% of the total sales of bearings are to original equipment manufacturers (OEMs), while the remaining 40% are market/replacement sales that fetch higher margins.

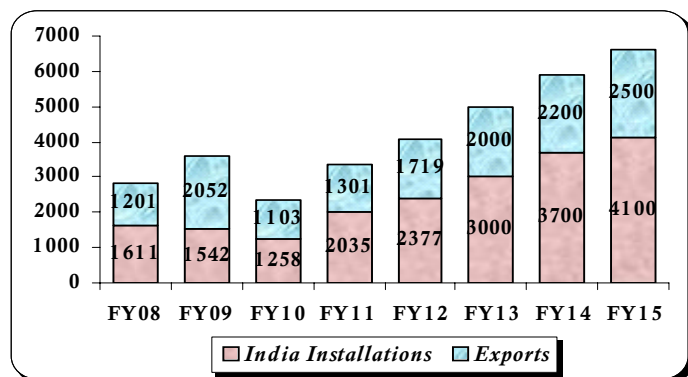
The company's sales are not heavily dependent on any particular sector as it derives equal share of revenues from automobile bearing and industrial bearing. Within the automobile space too, the passenger-car vehicle, two-wheeler and commercial-vehicle space contributes more or less equally to sales. Within the industrial space, SKF India caters to virtually all industries namely cement, steel, wind, power, mining, construction, transmission & distribution, oil & gas, and food & beverage.

Moreover currently about 90% of its total revenues arise out of the bearing business. SKF is planning to expand its seals, lubricants, services and mechatronics business and is focusing more to make it constitute about 20% of its total revenues in the next two years.

This diversified revenue base acts as a hedge against slowdown in any particular sector, while giving the company ample opportunities to benefit in a growing economy.

Tie-ups with reputed players

India Wind development (in MW)

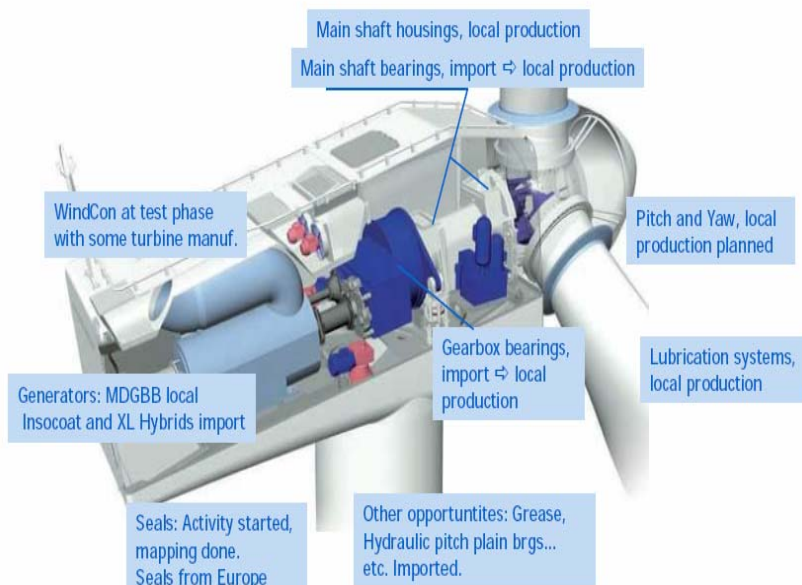


Source: SKF Estimates based on moderate growth for Suzlon and conservative scenario projections from Wind manufacturers

SKF India has tied up with Hero Honda for meeting all its bearing requirements for the next four years till 31st December, 2014. The company being one of the few suppliers of windmill bearings is expected to deliver robust growth from this sector in the long run. To cash in on the immense potential, it has entered into a tie up for 5.5 years with Suzlon for supplying the bearings used in wind turbines. Total contract value of the agreement is worth 303 million euro. This contract has strong revenue generating visibility. However, the plans are delayed for the time being due to slowdown in wind energy but the company is hopeful to start by next calendar year.

SKF optimistic on India growth story

SKF offers for the Indian Market



SKF Global wants to make SKF India a manufacturing hub for its different products like small ball, roller bearings and customised products that demand manual craft. The company has been present in India for more than 85 years and it is a very important market for them, both in terms of business and for the development of their products. Currently exports make up about 10% of SKF India's sales. Robust domestic demand is preventing SKF Global to export more from India.

The opening of two new factories further shows SKF's strong commitment to support its growth in India. India's importance in SKF's scheme of things is also marked by its recent plans to add 500 new jobs in India even as it decided to cut back up to 1,600 jobs globally in 2010.

SKF solution factory to act as a one stop shop

SKF established its first 'SKF solution factory' in India at Pune last year. The ultimate objective of the SKF solution factory is to make SKF offerings from its five technology platforms - bearings and units, seals, mechatronics, services and lubrication solutions - more available for customers and provide them with customized solutions by combining and integrating different products, systems and services. SKF Solution Factory Pune currently offers bearing remanufacturing and spindle services. Going forward, it will add customized product services, remote diagnostics, customized sealing solutions, lubrication oil station assembly, etc. SKF's continuous effort to expand and bring out innovative solutions, will further increase its share in the developing 2 wheeler and automotive industry

Strong parentage

SKF India is a part of the SKF Group, Sweden, the leading global supplier of rolling bearing and seals. Today, the company is represented in more than 130 countries. It has more than 100 manufacturing sites supported by about 15,000 distributor locations. SKF's knowledge of trends and needs of various developed and developing markets provides the necessary advantage to foresee and work with original equipment manufacturers in their new product development.

Notably, with global players looking at enhancing their capacities in India, SKF can enjoy an edge over its peers to supply to these OEMs in India.

Encouraging sector outlook

Bearing Industry is likely to witness good times ahead riding on auto sector boom, economic revival and export growth. The sturdy acceleration in automobiles in the country has had a compounding effect on a manufacturer like SKF. There is an unprecedented boom in the automotive sector, led by strong sales in the car and two wheeler segments while the industrial sector comprising of metals, mining, cement, power etc have recovered at a fast pace. The Index for Industrial Production has in recent months, indicated a return to high growth days in manufacturing sector. Moreover the Indian Railways, well supported by government's drive towards expansion and modernization, is showing encouraging increase in the bearing demand. Leading bearing players like SKF India are expected to benefit immensely going ahead, as demand growth in key user industries is expected to rise sharply.

Healthy growth prospects

SKF India has declared an excellent set of numbers in Q1CY10 on the back of robust demand from the key user industry segments such as automobiles and Industrials. Net profit more than tripled to Rs 44 crore on the back of 58% growth in topline and 570 basis points surge in operating profit margins to 13.2%. With the Indian economy fast getting back to growth trajectory and surging automobile sales, demand for SKF India's products will significantly grow in coming years. Revenues and Net Profit are estimated to grow at a compounded annual growth of 23% and 17% respectively over the CY2009-11E.

Peer Comparison

Company Name	Equity (Rs Cr)	CMP (Rs)	P/E	P/BV	D-E Ratio	ROCE (%)	PBIDTM (%)	EV / EBIDTA
FAG Bearings	16.6	546.0	12.2	1.9	0.0	23.3	14.2	7.0
NRB Bearings	9.7	88.1	17.5	2.1	0.7	6.6	12.0	7.4
SKF India	52.7	448.5	17.6	3.1	0.0	21.2	10.4	9.7
Tmken India	63.7	136.1	24.0	2.5	0.0	14.5	16.3	15.8

Financials

Quarterly Results		In Rs. Crores		
		Q1CY10	Q1CY09	% Chg.
Net Sales		504.28	317.50	58.83
Other Income		0.00	0.00	-
	Total Income	504.28	317.50	58.83
Total Expenditure		434.69	292.07	48.83
	PBIDT	69.59	25.43	173.65
Interest		(3.97)	(4.52)	(12.17)
Depreciation		7.50	7.28	3.02
	PBT	66.06	22.67	191.40
Tax		22.49	8.16	175.61
	Net Profit	43.57	14.51	200.28
EPS (F.V. 10) -		8.26	2.75	200.28



Profit & Loss					In Rs. Crores	
Year ended 31 st March	CY07	CY08	CY09	CY10E	CY11E	
Net Sales	1567.46	1627.37	1574.97	1952.96	2382.61	
Growth (%)	16.92	3.82	(3.22)	24.00	22.00	
Other Income	24.00	26.25	26.28	26.50	27.00	
Total Income	1591.46	1653.62	1601.25	1979.46	2409.61	
Total Expenditure	1312.89	1429.61	1428.41	1685.08	2048.90	
PBIDT	278.57	224.01	172.84	294.38	360.71	
Interest	0.38	0.68	0.76	0.80	0.80	
PBDT	278.19	223.33	172.08	293.58	359.91	
Depreciation	30.83	28.94	28.98	46.77	48.77	
Tax	86.65	66.73	48.85	83.92	105.79	
Reported PAT	160.71	127.66	94.25	162.89	205.35	
Extra-ordinary Items	0.65	(0.27)	0.37	0.00	0.00	
Net Profit	160.06	127.93	93.88	162.89	205.35	
EPS (Rs.)	30.35	24.26	17.80	30.89	38.94	

Balance Sheet					In Rs. Crores	
Year ended 31 st March	CY07	CY08	CY09	CY10E	CY11E	
SOURCES OF FUNDS						
Equity Share Capital	52.73	52.73	52.73	52.73	52.73	
Reserves	492.52	592.42	662.00	888.92	1021.09	
Total Shareholders Funds	545.25	645.15	714.73	941.65	1073.82	
Total Debt	0.19	0.15	0.10	0.15	0.15	
Total Liabilities	545.44	645.30	714.83	941.80	1073.97	
APPLICATION OF FUNDS						
Net Block	168.85	175.81	201.67	610.00	611.22	
Capital Work in Progress	27.92	62.85	55.10	50.00	50.00	
Investments	0.00	0.00	0.00	0.00	0.00	
<u>Current Assets, Loans & Advances</u>						
Inventories	164.80	224.49	182.04	242.87	304.06	
Sundry Debtors	206.02	215.05	216.29	249.98	297.83	
Cash and Bank	236.30	191.93	289.26	120.80	173.83	
Loans and Advances	63.42	80.41	135.99	156.24	181.08	
Total Current Assets	670.54	711.88	823.58	769.89	956.79	
<u>Less: Current Liabilities and Provisions</u>						
Current Liabilities	249.80	241.97	302.60	390.59	452.70	
Provisions	66.93	61.00	63.76	98.50	92.35	
Total Current Liabilities	316.73	302.97	366.36	489.09	545.05	
Net Current Assets	353.81	408.91	457.22	280.80	411.75	
Miscellaneous Expenses not written off	0.00	0.00	0.00	0.00	0.00	
Net Deferred Tax	(5.14)	(2.27)	0.84	1.00	1.00	
Total Assets	545.44	645.30	714.83	941.80	1073.97	

Key Financial Ratios					
Year ended 31st March	CY07	CY08	CY09	CY10E	CY11E
Growth Ratios					
Revenue (%)	16.92	3.82	(3.22)	24.00	22.00
PBIDT (%)	52.00	(19.59)	(22.84)	71.95	22.53
Net Profit (%)	60.62	(20.07)	(26.62)	73.51	26.06
EPS (%)	60.62	(20.07)	(26.62)	73.51	26.06
Margins					
Operating Profit Margin (%)	16.24	12.15	9.31	13.72	14.01
Net Profit Margin (%)	10.21	7.86	5.96	8.34	8.62
Return					
ROCE (%)	45.42	30.23	20.13	26.29	29.05
RONW (%)	29.36	19.83	13.14	17.30	19.12
Valuations					
Market Cap / Sales	1.40	0.40	1.18	1.21	0.99
EV/PBIDTA	7.82	2.32	9.69	7.60	6.06
P / E	15.61	5.75	21.65	14.47	11.48
P / BV	4.43	1.10	2.75	2.69	2.18
Other Ratios					
Debt-Equity Ratio	0.00	0.00	0.00	0.00	0.00
Current Ratio	2.12	2.35	2.25	1.57	1.76
Interest Cover Ratio	651.95	286.87	189.29	309.51	389.92
Turnover Ratios					
Fixed asset turnover	9.28	9.26	7.81	3.20	3.90
Total asset turnover	2.87	2.52	2.20	2.07	2.22
Debtors turnover	7.61	7.57	7.28	7.81	8.00
Inventory turnover	9.51	7.25	8.65	8.04	7.84

Risk & Concerns

- ✚ Steel constitutes about 45% of the raw material cost. Hence, any adverse fluctuation in the price of steel can affect the margins of the company.
- ✚ Stiff competition from domestic bearing companies and possibility of growing imports from China continue to pose a major challenge to the Company.
- ✚ Despite the overall positive industrial outlook, there are concerns that rising inflation will play spoilsport. At the same time drop in exports demand will put pressure on the prices and margins.
- ✚ Economic slowdown and Auto sector slowdown can hit the bearing industry's overall growth and of its companies.

Valuation & Recommendation

The demand for bearing industry is derived from demand in two key user segments- automotive and industrial sector, both of which have seen sharp turnaround in fortunes in the last few months. SKF India being the largest bearing company in India is expected to be one of the prime beneficiaries of the up-tick in the economy and growing vehicle demand.

Over the coming years, India is expected to become the new global hub for automobile manufacturing both for domestic as well as overseas markets. With a strong local presence and global parent's commitment to the Indian market, SKF and its parent company will be able to leverage their relationships with OEMs to get new businesses from all the OEMs operating outside India.

SKF India has a diversified revenue base, which acts as a hedge against slowdown in any particular sector, while giving the company ample opportunities to benefit in a growing economy. The company will continue to pursue its growth process through continued business development, R&D, productivity and technology innovation measures.

We believe with the Indian economy is fast getting back to growth trajectory and with surging automobile sales, the demand for SKF India's products will significantly grow in coming years. Revenue and Net Profit are estimated to grow at a compounded annual growth of 23% and 17% respectively over the CY2009-11E.

Given the robust sector outlook, recent capacity expansion, strong presence in a growing market and debt free balance sheet, this stock seems a good buy.

At the current price of Rs 447, the stock trades at a P/E multiple of 14.5 x CY10E earnings and 11.5 x CY11E earnings. With this backdrop we believe this to be an excellent opportunity for investors, we recommend a "BUY" on the stock with a price target of Rs 584, assuming a P/E multiple of 15 x CY11E earnings, an upside of 31% from the current levels, over a period of 12 months.

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